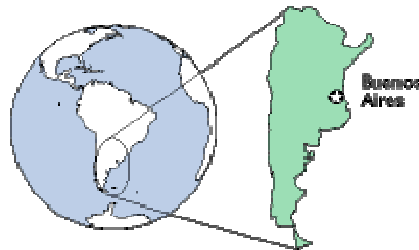


# COUNTRY REVIEW

## Argentina



June 2011

**ANALYST: David Atkinson**

**EULER HERMES COUNTRY RISK GRADE: D**

Country Risk Grades are on a scale of AA, A, BB, B, C, D  
where AA is the lowest and D the highest risk.

## Strengths

- The democratic framework proved durable through severe economic crisis, notwithstanding Argentina's long history of dictatorship and military coups.
- External debt restructuring on sustainable terms and moderate debt ratios.
- Strong external liquidity position.

## Weaknesses

- Fractious political system and elections due in October 2011.
- Poor long-term growth record and history of financial crises.
- Dependence on high commodity prices.
- Use of heterodox policies (e.g. price controls, export taxes) and delays to key reforms (e.g. public utilities).
- Rapid growth of primary public spending.
- Accelerating inflation and lack of credibility of official inflation data.
- External debt restructuring not fully concluded (hold out bondholders and Paris Club).
- Lack of access to international finance.
- Adequate but below average Structural Business Environment.

## Country Risk Assessment

Ratings	Argentina Latest	Median Grade D	Venezuela	Peers Brazil	Mexico
<b>Systemic Political Risk:</b>	<b>P2-</b>	<b>P2-</b>	<b>P3-</b>	<b>P2-</b>	<b>P2+</b>
<b>Systemic Economic Risk:</b>	<b>E6</b>	<b>E3</b>	<b>E3</b>	<b>E3</b>	<b>E3</b>
ME rating:	ME6	ME3	Me6	ME3	ME3
<i>Structure</i>	6.0	6.0	6.0	4.0	2.3
<i>Policy</i>	3.3	5.6	6.0	2.8	5.2
<i>Solvency</i>	4.6	4.3	2.2	2.2	2.2
<i>External Liquidity</i>	6.0	4.3	6.0	1.0	2.8
SBE rating:	SBE4	SBE2	SBE6	SBE3	SBE3
<b>COUNTRY GRADE:</b>	<b>D</b>	<b>D</b>	<b>D</b>	<b>BB</b>	<b>BB</b>

**Nomenclature:**

Political Risk Ratings are on a scale of P1 (lowest risk), P2+, P2-, P3+, P3-, P4 (highest risk).

Economic Risk Ratings are on a scale of E1 (lowest risk), E2, E3, E4, E5, E6 (highest risk).

ME (Macro-Economic) ratings are on a scale of ME1 (lowest risk), ME2, ME3, ME4, ME5, ME6 (highest risk).

The constituent parts of the ME rating are on a scale of 1.0 (best) to 6.0 (worst).

SBE (Structural Business Environment) ratings are on a scale of SBE1 (best), SBE2, SBE3, SBE4, SBE5, SBE6 (worst).

Country Grades are on a scale of AA, A, BB, B, C, D where AA is the lowest and D the highest country risk.

Source: Euler Hermes

## ECONOMIC STRUCTURE

<b>Country Profile</b>	
Capital city:	Buenos Aires
Population:	40.28 mn (2009)
GDP:	USD 308740 mn (2009)
Currency:	Argentina peso (ARS)
Form of state:	Republic
Head of government:	President Cristina Fernandez de Kirchner
Next elections:	Presidential & Legislative October 2011

<b>Major Industries (% of GDP at constant prices, 2010)</b>	<b>Global Assumptions</b>	2010	2011
Agriculture, forestry & fishing	Real GDP grth (% yr/yr) *	3.3	2.9
Mining	Inflation (% av) *	1.2	1.4
Manufacturing	Dated Brent (USD/b)	80	110
Construction & Utilities	* World		
Services			

<b>Main Exports (% of total, 2010)</b>	<b>Main Imports (% of total, 2010)</b>
Primary products	Consumer goods
Manufactures (agricultural origin)	Intermediate goods
Manufactures (industrial origin)	Fuels
Fuel & energy	Capital goods
	Other

## Basic indicators

<b>Selected economic indicators</b>	2007	2008	2009	2010e	2011f
Nominal GDP (USD mn)	262,455	330,191	308,740	370,263	397,155
Population (mn)	39.49	39.88	40.28	40.68	41.08
GDP per capita (USD)	6,646	8,280	7,665	9,102	9,668
Real GDP growth (% yr/yr)	8.7	6.8	0.9	9.2	5.3
Inflation (% eop)	8.5	7.2	7.7	10.9	12.0
Fiscal balance (% of GDP)	1.1	1.4	-0.6	0.2	-1.0
Current account balance (% of GDP)	2.8	2.0	3.6	1.0	0.0
External debt/GDP (%)	48	38	38	35	33
External debt/Exports of goods & services (%)	183	149	167	155	136
Interest payments/Exports of goods & services (%)	6	4	5	5	5
Foreign exchange reserves (USD mn)	44,682	44,855	46,093	49,734	49,500
Import cover (months)	10.0	7.9	11.2	8.8	7.1
Exchange rate assumption, COP:USD (av)	3.10	3.14	3.71	3.90	4.25
f: CRU central forecast					

Sources: National, IMF, World Bank, Euler Hermes

## Political Stability

Despite a long history of dictatorships and military coups, the democratic framework in place since 1983 has proved remarkably durable. It was severely tested during the financial and economic collapse of 2001-02, as two presidents were forced to resign in quick succession and were followed by an interim presidency appointed by congress, but constitutional processes were maintained. Under President Nestor Kirchner of the Partido Justicialista (JP or Peronists) 2003-07 and his successor Cristina Fernandez de Kirchner (Nestor's wife) in office since 2007 stability has improved considerably, but the system remains fractious, institutions relatively weak and policies still prone to boom and bust.

Presidential and partial legislative elections are due in October this year. President Fernandez has declared her candidacy for a second-term and opinion polls at this stage suggest that she is well placed. Candidates have until 25 June to declare officially. There had been some doubts about whether she would stand, partly over health issues and partly to her resolve, after the untimely death in 2010 of her husband, former president Nestor Kirchner, who had remained a powerful influence after leaving office, and was widely expected to run for a second term in 2011. For the opposition, which has been fragmented for some time, Ricardo Alfonsín, son of former president Raul Alfonsín, of the UCR is beginning to emerge as the main candidate. The Kirchner's FV faction within the JP (Peronist) party, however, suffered a resounding defeat in the mid-term legislative elections in 2009, losing its majority in congress and Nestor Kirchner himself suffered a defeat in the election. This has made policy implementation more difficult but the president has and uses extensive powers to rule by decree. The absence of Nestor Kirchner also adds a note of uncertainty over the effectiveness of the administration.

Under the Kirchners economic policy has moved in the direction of greater state intervention and away from economic orthodoxy. The government relies on central bank intervention as appropriate to manage the exchange rate to provide adequate foreign exchange and export taxes, while supporting domestic growth with state spending. However, when commodity prices are high and Brazil grows strongly strong export revenues tend to create inflationary pressure, as monetary policy also tends to be expansionary. Conversely, when export revenues are weak, a fiscal deficit is likely to emerge which is also likely to create financing problems and/or put excessive downward pressure on the exchange rate. Cut off from international financing the government has resorted to direct intervention to provide funding via re-nationalisation of the pension system and obtain FX reserves from the central bank, which has little or no independence. Also, concerns over the transparency of inflation data and prioritisation of growth over inflation, along with the government's confrontational populism do not help long-term investment prospects.

It is unclear what policies will emerge post-election. President Fernandez has shown little inclination to depart from populist state interventionism pre-election but adjustment of the economy is likely to be necessary before too long. The options will be to shift back towards orthodoxy or become more radical. Either is possible, though there must be concerns that the latter will prevail. A more centrist president and government would probably begin to tackle the imbalances earlier.

Relations with the IFI's and the IMF have improved, but it is unlikely that financial support would be forthcoming readily in the event of a financing crisis. Relations with Venezuela's President Chavez remain good, though provision of financing from this source has become more constrained. Relations within Mercosur also remain important, especially with Brazil.

## Economic Stability

Frequently disastrous economic policies and political instability have led to volatile growth over an extended period, oscillating between boom and bust, despite a rich endowment of agricultural resources. Exports are mainly primary products and value-added goods from the agricultural sector, along with energy, and are concentrated on neighbouring countries, especially Brazil and Chile. Exports of soya and products account for 20-25% of total exports. Consequently, the economy is vulnerable to changes in commodity prices. Since the collapse of the economy in 1999-02 when output fell by around 20%, real GDP growth and growth of real GDP per capita have been relatively strong, with the exception of 2009 when growth dipped to 0.9%, though this was better than most economies recorded during the global recession.

Growth in 2010 recovered strongly and real GDP expanded by 9.2%, driven by domestic demand as private and public consumption grew by around 9% and investment increased by 20%, after contracting by more than 10% in 2009. The contribution of net exports was negative as imports, having suffered a sharper decline in 2009, grew much more rapidly than exports. In 2011 growth is expected to ease to 5-6%, though there is unlikely to be significant policy tightening ahead of the elections in October and the risks to growth are probably on the upside (absent a global relapse,

which is not our central scenario). Expected growth in 2011 is well above the average of the past ten years. After the elections, however, going into 2012 some policy adjustment would seem necessary to rein in inflationary pressure and growth may ease further.

Monetary policy is largely geared to management of the exchange rate and reserve accumulation. Money supply and domestic credit are expanding strongly and the bank's monetary target of 42% growth in 2011 does not indicate a less expansionary approach in the near future. Inflation has accelerated and according to official data was 10.9% yr/yr at end-2010, up from 7.7% at end-2009. The pace moderated slightly yr/yr to 9.7% in April 2011 (running at a mo/mo rate of 0.8%) but is likely to end the year around 12%. However, the reliability of official data has been questioned and some private estimates put observed inflation around 25%. The IMF was asked to review the inflation index and has submitted a technical report, but a new index is not expected until 2013. Whichever rate is used, inflation is likely to accelerate further without policy adjustment post-election.

After several years of surplus, there was a small fiscal deficit (NFPS) in 2009 as the economy slowed. Strong revenue growth in 2010 offset another year of 30% growth of spending and the fiscal balance returned to a small surplus of 0.2% of GDP, but in 2011 is likely to return to a deficit of around 1% of GDP and widen further in 2011. The primary surplus has also declined and will be around 1% of GDP in 2011. Using the IMF definition and data the overall general government deficit is expected to widen to more than 3% of GDP in 2011 and remain at that level in 2012. The weakening trend will continue without policy adjustment and a deficit may re-emerge in 2012. The public debt-GDP ratio was 44% at end-2010 and gross funding requirements in 2011 are 5.2% of GDP, according to recent IMF estimates. However, in the near-term, assuming that there is no collapse of commodity prices or other global disruption, access to pension funds and other domestic resources as well as the FX reserves of the central bank, funding should be manageable, though FX reserves will be quickly eroded in the event of an adverse external or internal shock with little obvious way of replacing them.

The external current account remained in surplus in 2010 but declined to 1% of GDP as both imports and exports recovered from their falls in 2009, but the former grew at double the pace of the latter. Currently high commodity prices indicate rough balance for the current account in 2011, though with more than 50% of exports based on primary products (including agriculture) and 20-25% on soya alone the projection is highly sensitive to global economic conditions, followed by a deficit in 2012. FDI has picked up from the lows of 2009, but is not back to pre-global crisis levels. FX reserves have continued to increase and provide 8.8 months of import cover. FX reserve coverage of debt payments due in 2011 is less strong at 120%.

External debt ratios are moderate, following extensive debt reduction after earlier default, though the debt service ratio is on the high side. The external debt-GDP ratio at end-2010 was 35% and the external debt-exports of goods and services ratio was 154%, while interest payments due were around 4% of exports of goods and services. However, there are still arrears on external debt. Also, while the private sector debt has been restructured, though there are still some holdouts, there has not as yet been an agreement on debt owed to Paris Club creditors and a deal seems unlikely before the elections in October. The government still lacks access to international finance, though some local issuers have returned to the market, albeit at high interest rates, and there must be serious questions over the likelihood of provision of finance by the IFIs in the event of a crisis.

High inflation, deteriorating public finances, the potential volatility of commodity prices and lack of access to international financial support remain concerns and constraints on the risk profile. Moreover, there is little to suggest a change of approach from the current government, though the elections may change the outlook. Negotiations with the Paris Club may also turn out positive and improve access to international finance. Short term financial flow indicators also do not point to an imminent crisis.

## Structural Business Environment

The Structural Business Environment is below average in our assessment. Based on data and definitions from the World Bank's 2011 Doing Business Survey, Registering Property, Protecting Investors and Trading Across Borders were weaker areas, ranking below average, and Starting a Business, Dealing with Construction Permits and Paying Taxes were particularly weak. The World Bank Institute's Governance Research Indicator puts Regulatory Quality, Control of Corruption and Rule of Law above average for the Latin American Region. Transparency International's Corruption Perception Index, 2009, assigns Argentina a score of 2.9—on a scale of 1 (bad) to 10 (good)—and a ranking of 105= out of 178 (the same as Algeria and Kazakhstan among others). As a broad measure of the pro-business environment The Heritage Foundation's 2011 Index of Economic Freedom ranks Argentina 45 (of 179).

David Atkinson

London: +44 (0)20 7860 2807

Charts

